

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Morrow Analyst: Gloria McConnell Bill Number: SB 948

Related Bills: None Telephone: 845-4336 Introduced Date: 02/21/03

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Exclusion/Income of Spouse of Member of Armed Forces Who Dies While in Active Service as a Result of Military, Combat, or Terrorist Action

SUMMARY

Under this bill, all earned income of a spouse of a member of the Armed Forces who dies as a result of certain action would be exempt from income taxes for the year of the member's death and the following three years.

PURPOSE OF THE BILL

The apparent purpose of this bill is to give a tax benefit to spouses of members of the Armed Forces who die in a military, combat or terrorist action.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately and apply to taxable years beginning on or after January 1, 2003.

POSITION

Pending.

Summary of Suggested Amendments

Department staff is available to assist with amendments to resolve the implementation and technical concerns discussed in this analysis.

ANALYSIS

FEDERAL/STATE LAW

Under federal and state law, a surviving spouse of a decedent is taxed at the joint return rate for the year of death and the following two years if the surviving spouse:

- has not remarried at any time before the close of the taxable year;
- pays more than 50% of the costs of a household as his or her home, which is the principal place of abode of a son or daughter (including adopted and foster children) or a stepson or stepdaughter;
- is entitled to claim at least one child as a dependent; and
- was entitled to file a joint return with the deceased spouse for the year of death.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
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<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director
Gerald H. Goldberg

Date
04/09/03

Taxable income of the following individuals is exempt from tax:

- active members of the U.S. Armed Forces who die or as a result of wounds, disease, or injury incurred die while serving in a combat zone, including certain hazardous duty areas;
- certain individuals in missing status; and
- military or civilian employees of the U.S. who die as a result of wounds or injury incurred outside the U.S. in terroristic or military action.

For purposes of this tax exemption:

“Armed Forces of the United States” is defined under IRC § 7701, and used for purposes of IRC § 692, to include all regular and reserved components of the uniformed services that are subject to the jurisdiction of the Secretary of Defense, the Secretary of the Army, the Secretary of the Navy, or the Secretary of the Air Force, and also includes the Coast Guard. Members also include commissioned officers and personnel below the grade of commissioned offices in such forces.

“Combat zone” under IRC § 112, and referred to in IRC § 692, in pertinent part, means “any area which the President of the United States by Executive Order designates as an area in which Armed Forces of the United States are or have (after June 24, 1950) engaged in combat.” In addition, such zones include qualified hazardous duty areas.

“Terroristic or military action” under IRC § 692 means:

- (A) any terroristic activity which a preponderance of the evidence indicates was directed against the United States or any of its allies, and
- (B) any military action involving the Armed Forces of the United States and resulting from violence or aggression against the United States or any of its allies (or threat thereof).

THIS BILL

Under this bill, eligible income received by a spouse of a member of the Armed Forces would be excluded from gross income if the member while in active service dies as a result of a military, combat, or terrorist action.

“Eligible income” would mean income earned by a spouse of a member of the Armed Forces of the United States in the taxable year in which the date of the member’s death falls and in each of the three following taxable years.

“A member of the Armed Forces of the United States” would include, but is not limited to, United States Coast Guard personnel engaged in maritime police power operations, the members of the California National Guard, and the members of federal military reserves when those reserve component personnel are serving on federal active duty of at least one day in duration.

“Military, combat, or terrorist action” would mean any of the following:

- Any military action involving the Armed Forces of the United States that results from violence or aggression against the United States or any of its allies, or threat thereof.
- Any combat training exercise.
- Any terrorist activity that was directed against the United States or any of its allies, shown by a preponderance of the evidence.

IMPLEMENTATION CONSIDERATIONS

California's Personal Income Tax Law (PITL) generally follows federal law. As such, PITL uses many of the definitions used in federal law. This bill would provide different definitions for "a member of the Armed Forces of the United States" and "military, combat, or terrorist action" from those currently provided under state and federal income tax law. In addition, it is unclear what is meant by "earned income." It would ease administration of this bill if the bill used definitions consistent with those used under current law. If modifications to the current definitions are needed to achieve the intent of this bill, staff suggests the bill be amended to make reference to the applicable current law section and then provide a modification to that definition by identifying the specific targeted item to be included or excluded.

- "Armed Forces of the United States" under this bill lists members of the military; however, the list is merely illustrative and is not a limitation. It is unclear which additional military members are included in this definition. Perhaps the definition used for IRC 692, which appears to be more inclusive, could be used for purposes of this bill.
- The definition of "military, combat, or terrorist action" under this bill in some instances is significantly broader than an existing definition and, in other respects, narrower. For example, the law that exempts the income of members who die in a combat zone or as a result of military or terroristic action (IRC § 692) expressly excludes training exercises. For purposes of this bill, combat training exercises would be included. On the other hand, federal law provides exemption for members of the armed forces who die in a "combat zone" and qualified hazardous duty areas. Under this bill, combat zones and hazardous duty are excluded.
- The definition "earned income" under current law has various meanings depending upon the item to which it relates. Earned income may include self-employment income, wages, or compensation, including cash benefits. Consequently, it is unclear whether under this bill "earned income" would include interest earned from financial institution deposits, earnings from dividends and royalties, or earnings from pensions, annuities, and retirement deposit accounts.
- The income exemption under this bill would apply only if the member dies "as a result of a military, combat, or terrorist action." If a member dies while serving in a combat zone, current law would exempt his or her income from tax (IRC § 692). However, it is unclear whether under the same circumstances the spouse's earnings would be exempt under this bill, as the death may not be considered a "result of a military, combat, or terrorist action."

Staff is available to assist the author with any other implementation considerations that may be identified as the bill moves through the legislative process.

OTHER STATES' INFORMATION

Review of *Illinois*, *Massachusetts*, *Michigan*, *Minnesota*, and *New York* laws found no comparable tax exemption for spouses of members of the Armed Forces who die. These states were reviewed due to their similarities to California's economy, business entity types, and tax laws.

FISCAL IMPACT

Departmental Costs

If the bill is amended to resolve the implementation considerations addressed in this analysis, the department's costs are expected to be minor.

ECONOMIC IMPACT

Revenue Estimate

Revenue losses from this bill would be very minor, less than \$10,000 for every 100 deaths of California military personnel.

Revenue Discussion

Due to data limitations and uncertainties regarding future events, revenue losses are based on a per 100 deaths of members of the Armed Forces. For this analysis it is assumed that for every 100 Armed Forces members who die, 75 percent of those are married and of those married half have spouses who work. Of the spouses who work it is assumed that they have an adjusted gross income (AGI) of \$32,000 a year (median California AGI for 2000). The average tax for a 2000 joint return with an AGI of \$32,000 was \$166. The revenue loss would be on the order of \$6,200 (100 deaths x 75 % married x 50% with working spouse x \$166 average tax revenue loss= \$6,200) for the first tax year.

ARGUMENTS/POLICY CONCERNS

This bill would provide the tax exemption without regard to whether the surviving spouse meets the requirements under the tax law, such as remaining unmarried during the period of exemption or maintains a household for a dependent child.

This bill would provide the tax exemption regardless of the amount of the surviving spouse's earned income, which for some spouses could be significantly higher than the median California AGI.

LEGISLATIVE STAFF CONTACT

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